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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 755

ESTATE OF RALPH SLOCUM DAVENPORT, DECEASED, UNITED STATES TRUST COMPANY OF NEW YORK, EXECUTOR, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 3a–7a)[1] are reported at 38 T.C. 670. The opinion of the Court of Appeals (Pet. A1–A6) is reported at 321 F. 2d 908.

JURISDICTION

The judgment of the Court of Appeals was entered on September 3, 1963 (Pet. A1, A7–A8). Petitions for rehearing and rehearing *en banc* were denied October 17, 1963 (Pet. A9–A10). The petition for

[1] Record references are to the appendix to the petitioner's brief in the Court of Appeals.

a writ of certiorari was filed on January 14, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Where property is bequeathed by the husband, in an American will, in trust for his wife for life with a general power of appointment over the remainder, does the widow's release of the power of appointment in settlement of a contest of the husband's French will (covering property in France) disqualify the trust property from the marital deduction under Section 2056 of the Internal Revenue Code and the applicable Regulations?

STATUTES AND REGULATIONS INVOLVED

Relevant portions of Sections 2033 and 2056 of the Internal Revenue Code of 1954 and Section 20.2056 (e)-2 of the Treasury Regulations on Estate Tax (1954 Code) are set forth in the Appendix, *infra*, pp. 11–13.

STATEMENT

The decedent, a United States citizen, died in Paris, France, on July 18, 1955. He left two wills. One, herein called the American will and executed in May, 1949, disposed of all his property except his property in France. By this instrument he devised and bequeathed his residuary estate valued at $768,630.01 to his wife, Yvonne, and to his three daughters by a former marriage. Each of his daughters and his wife were given one sixth of the residuary estate outright. The remaining one third of the residue was

placed in trust for the benefit of his wife for life and she was given a general testamentary power of appointment over the corpus. The second will, called the French will and dated June 28, 1955, devised to his wife full ownership of his home in France, "La Falaise", and also disposed of other property in France. However, each of the three daughters claimed a one-fourth interest under French law in the French real estate. (Pet. A2–A3; R. 4a.)

The American will was admitted to probate in New York on September 23, 1955. On November 8, 1956, following arm's length negotiations between Mrs. Davenport and her stepdaughters, an agreement was reached whereby Mrs. Davenport relinquished her power of appointment over the property left her in trust in return for the stepdaughters' executing and filing the appropriate documents to effect probate of the French will. (Pet. A3, A4.) The French will was probated in April 1957. (Pet. A3.)

Section 2056(a) of the Internal Revenue Cod of 1954 allows as a deduction from the value of the gross estate of a decedent an amount equal to the value of an interest in property included in the gross estate which "passes or has passed from the decedent to his surviving spouse." Section 2056(b) excludes from the marital deduction interests which are terminable in nature, such as a life estate. Section 2056(b)(5) expressly describes as a qualifying interest a life estate coupled with a general power of appointment in the surviving spouse. Treasury Regulations on Estate Tax (1954 Code), Section 20.2056(e)-2(d)(1),

provide that any property interest assigned or surrendered by a surviving spouse, as a result of a controversy involving the decedent's will or a bequest or devise thereunder, shall not be considered as having "passed from the decedent to his surviving spouse" for the purposes of the marital deduction.

The Commissioner disallowed $242,704.52 of the claimed marital deduction, representing the value of the one-third residuary estate placed in trust for the widow, on the ground that under Treasury Regulations on Estate Tax, Section 20.2056(e)-2(d)(1), it did not pass from the decedent to the surviving spouse because the general power of appointment was surrendered by Mrs. Davenport in settlement of a controversy involving the decedent's will. The resulting assessment of a deficiency in the amount of $87,823.69 was upheld by the Tax Court and by the Court of Appeals. (Pet. A4, A6; R. 7a.)

Both the Tax Court (R. 6a) and the Court of Appeals (Pet. A5-A6) found as a fact that there was a "controversy" over the French will, within the meaning of the regulation. The Court of Appeals rejected the taxpayer's contention that where a decedent elects to dispose of his estate by more than one testamentary instrument, Treasury Regulations, Section 20.2056(e)-2(d)(1) is inapplicable. Passing the question whether the two testamentary instruments here involved should be viewed as two "wills" or as a will and a codicil, the court reasoned that they constituted a single testamentary plan. Accordingly the Court of Appeals concluded that when the widow surrendered

her power of appointment over the trust property, it no longer qualified for the marital deduction (Pet. A4, A5).

ARGUMENT

The decision below is correct and, contrary to petitioner's assertions, no conflict of decisions or denial of due process is involved.

Section 20.2056(e)-2(d)(1), Treasury Regulations on Estate Tax (1954 Code) (Appendix, *infra*, p. 13), is an administrative application of the rationale of the landmark case of *Lyeth* v. *Hoey*, 305 U.S. 188. The essence of the doctrine is that, for federal estate tax purposes, where the compromise agreement represents a *bona fide* recognition of the enforceable rights of an heir or legatee against the estate, it is not the will but the substituted terms of distribution that determine what property passes to the heir or legatee from the decedent within the meaning of the federal estate tax law.

1. Petitioner contends that the decision below is in conflict with other decisions of this Court and of other Circuits "on the applicability of state law in Federal tax matters." (Pet. 8.) The contention is wholly without merit. Of the cases cited by petitioner in this regard, not one involves an issue as to either a marital

[2] Petitioner attempts to dispose of the *Lyeth* doctrine by stating that "the facts of that case are distinguishable" (Pet. 13, fn. 1). In reality, the two cases are quite similar. The property in dispute there was deemed to have passed for federal tax purposes from the decedent to an heir—who received the property after the will had been probated and after the property had vested under state law in another party—since the heir took ultimately under the terms of a settlement agreement.

deduction or a will controversy. Rather, they deal with ordinary income taxes (*Helvering* v. *Stuart*, 317 U.S. 154; *Lincoln Storage Warehouses* v. *Commissioner*, 189 F. 2d 337 (C.A. 3d); *Gould* v. *Commissioner*, 182 F. 2d 573 (C.A. 9th)), excess profits tax (*Graves, Inc.* v. *Commissioner*, 202 F. 2d 286 (C.A. 5th)), documentary stamp tax (*Phillips Petroleum Co.* v. *Jones*, 176 F. 2d 737 (C.A. 10th)), lien priority (*Fidelity & Deposit Co.* v. *New York City Housing Auth.*, 241 F. 2d 142 (C.A. 2d)), and income tax of an estate (*Frederich* v. *Commissioner*, 145 F. 2d 796 (C.A. 5th)).

The only case cited by petitioner in which an estate tax was in issue is *Morgan* v. *Commissioner*, 309 U.S. 78. That case, however, did not involve either the marital deduction or any will controversy; the question was whether a testamentary power of appointment was general (in which case it would be included in the gross estate for tax purposes) or special (in which case it would not be so included). In any event, the decision rejects petitioner's contention that state law is controlling (p. 80):

> * * * we hold that the powers are general within the intent of the Revenue Act, notwithstanding they may be classified as special by the law of Wisconsin.

In at least two further instances, the cases cited by petitioner held, contrary to petitioner's argument here, that the federal tax consequences were to be determined by federal law and not by the characterization of property rights under state law. In *Burnet* v. *Harmel*, 287 U.S. 103, an oil and gas lease, though regarded by state law as a sale of the oil and gas

in place, was held to be not a sale for federal tax purposes. In *Phillips Petroleum Co., supra*, an oil and gas lease, though not regarded as realty under state law, was nevertheless held to be realty for purposes of a federal documentary stamp tax. The other cases cited by petitioner merely acknowledge the obvious; namely, that Congress may, if it sees fit, confer tax consequences on property rights defined by state law. The essential point here, with regard to which the cases cited by petitioner present no conflict, is that federal estate tax law embodies under the circumstances here involved a concept of *passing* under which state probate proceedings, and the vesting of property rights for purposes of state law, are not necessarily determinative. *Lyeth* v. *Hoey, supra.*[3]

2. Petitioner's remaining points attack the decision below as a denial of due process. To the contrary, the decision is based on findings which are amply supported by the evidence, and on conclusions of law which are wholly correct.

As noted in the Statement, *supra*, the court below approved the finding of fact by the Tax Court that there was a controversy over the French will within

[3] In several other instances, Congress has specifically provided by statute for estate tax treatment of certain property which disregards rules of vesting under local law. For example, the following sections of the 1954 Internal Revenue Code provide for inclusion in the gross estate of property interests which under state law vest in someone other than the decedent prior to his death: Section 2035 (transactions in contemplation of death); Section 2036 (transfers with retained life estate); Section 2037 (transfers taking effect at death); Section 2038 (revocable transfers), and Section 2040 (joint interests).

the meaning of the pertinent regulation (Pet. A5–A6). The finding is clearly supported by evidence of record.[1] For example, the taxpayer's own petition in the Tax Court recited (R. 10a) that the daughters "withheld their consent to the probate of the French Will, claiming that the decedent died a French domiciliary and that the French Will was ineffective under French law to give the widow fee title to the decedent's home, La Falaise." The next sentence of the petition (R. 10a) refers to these circumstances as "This dispute." The agreement ultimately entered into by the widow and the daughters (R. 28a–30a) contains the following introductory clause (R. 28a):

> Whereas, some question has arisen or may arise as to the domicile of the decedent at the time of his death, and, as a consequence some question has arisen or may arise as to the enforceability of such of the provisions of the above-mentioned [i.e., French] will of the decedent * * * as direct a distribution to or for the benefit of the spouse * * *

The settlement of "This dispute" resulted in the surrender by the widow of the power to appoint the remainder interest covered by the testamentary trust. Thus, the effect of the settlement for tax purposes was that the remainder interest in the testamentary trust passed directly from the decedent to the daughters and a life estate in the trust passed from the decedent to the widow. The life estate, being a ter-

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[1] In its brief below, petitioner referred to the negotiations over the French will as a "controversy" or as a "dispute" on no less than fifteen occasions.

minable interest, does not qualify for the marital deduction. Section 2056(b) (Appendix, *infra*, pp. 11–12).

The case of *Harter* v. *Commissioner*, 39 T.C. 511, is cited by petitioner in an attempt to demonstrate that the Commissioner has acquiesced in a position inconsistent with the result below. No inconsistency exists.* *Harter* involved wholly different circumstances and a different section of the Treasury Regulations, namely, Section 20.2056(e)–2(e). That regulation provides that where, as in *Harter*, a taxpayer elects to take against his spouse's will, the share of the estate which devolves to him under local law shall qualify for the marital deduction. In other words, under these circumstances, federal law expressly confers tax consequences on certain operations of the local law of succession. In the case at bar, to the contrary, federal law confers tax consequences not on local probate law but on settlement agreements arising out of will controversies. Further, in *Harter* the surviving spouse transferred the property to the children only after the decedent's entire estate had been probated. In the case at bar, as we have seen, the widow's surrender of the power of appointment was a necessary condition precedent to the probate of the French will.

Petitioner further contends that, since the controversy here involved a will devising property in France not includible in the gross estate, the statutes and

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*Even if there were inconsistency, it is not clear by what reasoning petitioner concludes that this would be a denial to it of due process.

Regulations are not applicable. But the question of whether certain property passes to the widow within the meaning of Section 2056 is wholly distinct from the question whether certain other property is includible in the gross estate under Section 2033 (Appendix, *infra*, p. 11). The important point is that the daughters, and not the widow, received the remainder interest in the trust and that this was the consequence of the daughters' standing as heirs and under the compulsion of their unsatisfied claims.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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FEBRUARY 1964.

APPENDIX

Internal Revenue Code of 1954:

SEC. 2033. PROPERTY IN WHICH THE DECEDENT HAD AN INTEREST.

The value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of the interest therein of the decedent at the time of his death.

(26 U.S.C. 1958 ed., Sec. 2033.)

SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE.

(a) *Allowance of Marital Deduction.*—For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsections (b), (c), and (d), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

(b) *Limitation in the Case of Life Estate or Other Terminable Interest.*—

(1) *General rule.*—Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed under this section with respect to such interest—

(A) if an interest in such property passes or has passed (for less than an

adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse * * *; and

(B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse;

* * * * * * *

(5) *Life estate with power of appointment in surviving spouse.*—In the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse—

(A) the interest or such portion thereof so passing shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and

(B) no part of the interest so passing shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if such power in the surviving spouse to appoint the entire interest, or such specific portion thereof, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

* * * * * * *

(26 U.S.C. 1958 ed., Sec. 2056.)

Treasury Regulations on Estate Tax (1954 Code):

SEC. 20.2056(e)-2. *Marital deduction; definition of "passed from the decedent to his surviving spouse".*

* * * * *

(d) *Will contests.* (1) If as a result of a controversy involving the decedent's will, or involving any bequest or devise thereunder, his surviving spouse assigns or surrenders a property interest in settlement of the controversy, the interest so assigned or surrendered is not considered as having "passed from the decedent to his surviving spouse".

(2) If as a result of the controversy involving the decedent's will, or involving any bequest or devise thereunder, a property interest is assigned or surrendered to the surviving spouse, the interest so acquired will be regarded as having "passed from the decedent to his surviving spouse" only if the assignment or surrender was a bona fide recognition of enforceable rights of the surviving spouse in the decedent's estate. Such a bona fide recognition will be presumed where the assignment or surrender was pursuant to a decision of a local court upon the merits in an adversary proceeding following a genuine and active contest. However, such a decree will be accepted only to the extent that the court passed upon the facts upon which deductibility of the property interests depends. If the assignment or surrender was pursuant to a decree rendered by consent, or pursuant to an agreement not to contest the will or not to probate the will, it will not necessarily be accepted as a bona fide evaluation of the rights of the spouse.

* * * * *

(26 C.F.R., Sec. 20.2056(e)-2.)

U.S. GOVERNMENT PRINTING OFFICE: 1964